“The performance of the world economy, and the performance of economists”

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Economics in question[1]

There are broadly two criteria of ‘truth’ in science. One is consistency, the other, correspondence with evidence. Mathematics is the home of truth as consistency, observational sciences the home of truth as evidence. Economics tries to combine both. Neoclassical economics emphasizes truth as consistency; econometrics, evolutionary economics, and behavioural economics emphasize truth as correspondence with evidence. Neoliberal economics—a more ideologically loaded, anti-state version of neoclassical economics—tends to prescribe on the basis of consistent deduction from ‘first principles’ (simple models of rational agents and competitive markets), and to presume that what is derived from a model has the aura of truth and that what is not derived from a model is suspect or irrelevant. As Paul Krugman said about why economists failed to anticipate the Great Crash, ‘the economics profession went astray because economists … mistook beauty, clad in impressive-looking maths, for truth’ (2009, ‘How did economists get it so wrong?’, *New York Times Magazine*, September 6).

The discipline’s homogenization around an epistemology of mathematical formalization is just one part of the problem. A second part is the tie between mathematical formalization and an implicit ‘maxi-max’ decision rule: select the policy option which has as one of its possible outcomes one which is better than any possible outcome of other policy choices, without regard to the probability of that best outcome actually materializing. The third part is that this decision rule is applied with a presumption that the competitive market represents the ideal mechanism of collective choice. (DeMartino, George, 2011,*The Economist’s Oath: On the Need for and Content*

[1] / From Wade, R. - “The performance of the world economy, and the performance of economists”, a discussion of economists’ ethics.

of Professional Economic Ethics. New York: Oxford University Press; and 'Epistemic aspects of economic practice and the insufficiency of codes of conduct in economists', *Review of Social Economy*, forthcoming.)

So the conceptual framework is configured to generate the presumption that 'government failure is worse than **market failure**'. Yet it excludes some of the main sources of market failure. It assumes that technological learning is exogenous, thereby excluding the real-world market failures in technological learning in developing countries, especially when the learning is discontinuous rather than incremental. It assumes that the willingness of individuals to supply services to the market constitutes a reciprocal demand, precluding a more than temporary gap between aggregate supply and aggregate demand. **Keynesian** economics displaced this assumption (often known as Says Law), but the neoliberal counter-reformation of the 1970s and 1980s restored it to the centre of mainstream thought, and, with it, the efficacy and morality of free markets. It assumes that trade liberalization changes only the allocation of resources, not overall utilization of resources; which spirits away possible unemployment, deindustrialization, and the erosion of skills and firm-level capabilities. .

The framework also excludes the social and political defenses against the effects of these market failures, which may themselves compound the market failure. So for example the World Bank's, *World Development Report 2009: Reshaping Economic Geography* (2009*d*), says that unfortunately, 'governments intervene (usually incorrectly) to spread the benefits of economic growth more evenly across space'. It urges them not to do so, because uneven geographic development can be a primary means of stimulating economic growth. Yet the report says barely a word about the evictions, dispossessions, and destruction of communities which result from capital being given precedence over people, and the crime and resistance movements ('terrorists') spawned by these processes.

Again, the framework bolsters its anti-state bias by implicitly assuming that developing country governments are all of Weber's 'neopatrimonial' type, where the structure of state authority has little organizational or normative separation between the public and the private domains and public agencies are concentrations of inefficiency and corruption. It is as though all developing country governments are like Nigeria's. This, too, makes it easy to declare that 'government failure is worse than market failure'.

The combination of ‘government failure is worse than market failure’ and the maxi-max decision rule has led economists implicitly to put the discipline in the service of the owners and managers of capital. So they long resisted government regulation of finance on grounds that de-regulated financial markets promised bigger benefits than more regulated markets, hardly weighing the possibility that liberalized financial markets would pose appreciable dangers to the entire economy. They have long championed production globalization (transferring jobs to cheap labor sites or replacing them at home with machines), which is good for capitalists; and downplayed the loss of middle class jobs, on the presumption that other jobs would turn up. The normative glow around globalization obscures the ways in which global capitalism has been working at cross-purposes with democracy. As also does the definition of the field as ‘the market system’ rather than ‘capitalism’; for to take capitalism as the center of gravity would make it more difficult to ignore all the literature (from beyond the mainstream) on the inherent instabilities of the system.

The most spectacular failure of the profession reported in these pages -- the failure to anticipate the Great Crash and Long Slump in the west -- stemmed from these limitations at the conceptual heart of the discipline. The confidence with which the number two at the IMF announced in 2006 that ‘the world economy has rarely been in better shape’, and the chief economist of the OECD announced in mid 2007 that ‘Our central forecast … [is that] sustained growth in OECD economies would be underpinned by strong job creation and falling unemployment’, reflected the assumption that the knowledge which counts is knowledge derived from mathematical models of markets, coupled to the assumption that markets tend to adjust smoothly at the margins. The forecasters could be so confident because their Dynamic Stochastic General Equilibrium forecasting models contained no financial sector, and so – in line with the principle that what counts is what can be derived from the model -- they focused on The Great Moderation of the real economy and missed the build-up of financial fragility.

One of the biggest challenges for the economics profession is to rethink the present globalization institutional architecture, to devise one which encourages growth in poor countries and at the same time stops the repeated playing out of financial crises—as global investors, disappointed with the returns they are getting, think they have found new opportunities in some country or other and rush in money, then eventually face disappointment and pull out their money, raining social costs on the former favourites. The agenda has to include principles for coordinating exchange rate changes, regulation of private debt, caps on banks' capital, taxation of cross-border capital flows, and a requirement that financial firms keep a sizeable part of their capital in a form which automatically converts to equity as their capital position deteriorates, so as to give investors a stronger incentive to guard against reckless gambling. Since 2008 some progress in this rethinking is being made: for example, more economists have come to see the need for currency controls, for a financial transactions tax, and for central banks to 'lean against the wind' and curb asset bubbles.

These are difficult issues to be sure, yet relatively easy compared to the task of formulating and teaching ethics. The economics profession has suffered from an acute allergy to ethics; yet it should be giving even more attention to the ethical terrain on which its members operate than do the other social sciences, and at least as much as civil engineering and medicine. First, because of the impacts economists have on populations around the world, more than other social scientists. Second, because economists deal with those they purport to serve from a position of greater epistemic superiority than other social scientists, thanks to the unification of the discipline around mathematical formalization. Third, because they tend to operate on an assumption of epistemic certainty or sufficiency, and to insist that they know what is the best path for others to achieve their objectives. The best path, as in more globalization, more market liberalization as the default policy stance for all governments; Big Bang privatization and liberalization in the Former Soviet Union countries; free capital mobility in developing countries. Yet in the real world economists cannot know enough for their high confidence in the effects of the policies they recommend to be warranted. Outside of controlled conditions they necessarily operate with epistemic uncertainty or insufficiency. The ethics of the profession should therefore require them constantly to emphasize the uncertainties of the data, the limitations of their expertise, the potential dangers of their prescriptions not working out as planned; and to nurture a norm of 'complementary pluralism' in the discipline rather than defend mathematical formalization of neoclassical precepts as the single valid approach. But the subject of ethics for economists has long been buried beneath an ocean of silence. It is time to retrieve it. END